

EXECUTIVE SECRETARIAT
ROUTING SLIP

TO:

		ACTION	INFO	DATE	INITIAL
1	DCI				
2	DDCI		X	(W/o Atch)	
3	EXDIR				
4	D/ICS				
5	DDI		X	(W/O Atch)	
6	DDA				
7	DDO				
8	DDS&T				
9	Chm/NIC		X	(W/O Atch)	
10	GC				
11	IG				
12	Compt				
13	D/Pers				
14	D/OLL				
15	D/PAO				
16	SA/IA				
17	AO/DCI				
18	C/IPD/OIS				
19	NIO/ECON	X			
20	D/SOVA/DI		X		
21	D/OGI/DI		X		
22	NIO/USSR		X		
SUSPENSE		Date			

Remarks To 19: Please take lead in representing DCI; coordinate preparations w/NIO-USSR, SOVA and OGI. Include representative of DI as your "plus one." Effect direct liaison re attendance.

Meeting postponed to

3637 (10-81)

18 Dec

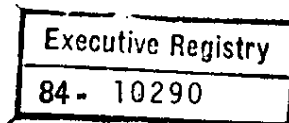
Executive Secretary
71 Dec 84

Date

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OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220



December 11, 1984

~~UNCLASSIFIED~~
(With Confidential Attachment)

MEMORANDUM FOR THE VICE PRESIDENT
THE SECRETARY OF STATE
THE SECRETARY OF DEFENSE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF COMMERCE
THE SECRETARY OF TRANSPORTATION
DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
DIRECTOR OF CENTRAL INTELLIGENCE
UNITED STATES TRADE REPRESENTATIVE
ASSISTANT TO THE PRESIDENT FOR NATIONAL SECURITY AFFAIRS
ASSISTANT TO THE PRESIDENT & DEPUTY TO THE CHIEF
OF STAFF
ASSISTANT TO THE PRESIDENT FOR CABINET AFFAIRS
CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS
ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT

SUBJECT Senior Interdepartmental Group on
International Economic Policy (SIG-IEP)

A meeting of the SIG-IEP is scheduled to be held on Thursday,
December 13, at 10:00 a.m. in the Roosevelt Room.

The agenda is as follows:

1. U.S.-USSR Working Group of Experts Meeting in Moscow.

A discussion paper prepared by the Department of Commerce on
U.S.-Soviet trade issues is attached. Attendance will be principal
plus one.

Donald T. Regan

Attachment



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OVERVIEW OF U.S.-SOVIET TRADE ISSUES
FOR THE SIG-IEP

(C) The purpose of the SIG-IEP meeting is to review the objectives for the U.S. delegation to the January 8-10 U.S.-U.S.S.R. Working Group of Experts meeting in Moscow and to review current positions on the following policy issues the Soviets are likely to raise at the Experts meeting:

- o U.S. embargo on imports of seven Soviet furskins.
- o A nickel certification arrangement with the U.S.S.R.
- o Aeroflot landing rights.
- o U.S. port access regulations for Soviet ships.
- o U.S.-Soviet draft tax protocol.

(U) These issues are summarized in this overview paper and discussed in detail in the attached SIG-IEP issue papers.

Background

(U) Earlier this year, the President indicated his desire to build a more constructive working relationship with the Soviet Union on a reciprocal basis. To implement this objective, the Administration has initiated a series of steps to show the Soviet leadership that the United States is ready to engage in constructive and peaceful cooperation in a wide range of fields. Non-strategic trade was identified by the President as one such area where cooperation may be possible.

(U) The President offered to extend for another 10 years the Long Term Economic, Industrial and Technical Cooperation Agreement (EITCA) with the Soviet Union, and also to begin a process that may lead to convening a meeting of the Joint U.S.-U.S.S.R. Commercial Commission (JCC)--the first such meeting since 1978. The Soviets agreed to the extension of the EITCA and also agreed to a meeting of the Working Group of Experts provided for in the EITCA. The Expert Group will meet in Moscow January 8-10, with the U.S. side headed by Under Secretary of Commerce Olmer and the Soviet side by Deputy Foreign Trade Minister Manzhulo. The purpose of the meeting is to determine if there is common ground to begin a process that may lead up to a JCC meeting.

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Declassify on: OADR

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(C) All discussions in the Experts Group will be in the context of present control policies. The U.S. delegation will not be discussing an expansion of goods or technologies available to the Soviet Union under U.S. and COCOM regulations and policies. The Experts Group, moreover, will not be setting any precedent among our allies in holding these meetings. Every major Western country has been having regular cabinet and sub-cabinet level trade meetings with the U.S.S.R.

Experts Group Objectives

(U) The U.S. goal of both an Experts meeting and possible JCC session would be to contribute to the objective enunciated by the President of finding areas for U.S.-Soviet cooperation in order to move toward a more constructive relationship. The Experts meeting, the first in six years, would review the status of overall U.S.-Soviet trade, discuss obstacles, and seek to identify areas in which mutually beneficial non-strategic trade could be expanded in conformity with present export control policies.

(C) The specific aim of the Experts meeting would be to lay the groundwork for a session of the Joint Commercial Commission. The first step should be a discussion of the areas in which each side is interested in expanding trade, and the second step being a matching of those interests where agreeable and acting to build on them. The Experts meeting should aim at finding sufficient ground for mutual agreement so that a Joint Commercial Commission meeting could be held which would result in some concrete steps to facilitate an increase in non-strategic trade. If the Experts Meeting shows that prospects for a successful Commission meeting are not satisfactory, discussions should continue on outstanding differences, and a Joint Commercial Commission meeting should be deferred.

(C) At the Experts meeting, wherever possible the two sides would delineate what steps each could take to facilitate expanded cooperation by U.S. firms and Soviet foreign trade organizations (FTOs). Specifically, we should be able to outline the areas in which we would be supportive of seeing bilateral U.S.-Soviet non-strategic trade growth, to express support for sales for certain projects, and to seek Soviet agreement that the actions we want to result from a JCC meeting will in fact be mutually agreeable.

(C) Within the universe of products and technologies that can be exported to the U.S.S.R., expansion prospects exist for U.S. companies. Most of these products and technologies are fully available from other Western suppliers to the Soviet Union without difficulty. In these areas, U.S. companies are prevented from

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competing in the Soviet Union with their Western competitors by Soviet attitudes and practices, such as:

- o Soviet purchasing agents can not visit the U.S. Commercial Office (USCO) in Moscow.
- o U.S. companies cannot hold sales seminars in USCO.
- o U.S. companies apparently have been eliminated from purchasing and bidding lists.
- o U.S. companies often have problems in getting visas, clerical help, travel, and so on.

(C) Changing these Soviet practices and supporting the efforts of American companies seeking non-strategic business opportunities in the Soviet Union can contribute to increased exports and to our economic well-being on which our national security depends. At the same time, it can help us to achieve the President's objective of "establishing a better working relationship between the U.S.S.R. and the United States" without in any way impairing our national security. Major overall gains are not likely, but for some U.S. products and companies they could be significant.

(U) Most U.S. products can be exported to the Soviet Union G-DEST, not requiring a validated export license. Of those products that are controlled, most are controlled for national security reasons. U.S. policy is to deny all license applications for national security controlled items to the U.S.S.R. which are COCOM-controlled. While oil and gas equipment and technology is under foreign policy export controls, most end-use oil and gas equipment can be exported, but technical data cannot. In addition, foreign policy controls prevent exports of equipment and data destined for Kama and Zil truck manufacturing facilities.

(C) The sectoral areas in which the expansion of non-strategic trade can be supported must be consistent with U.S. national security and foreign policy controls policies. Promotion should be avoided in industry sectors in which a high proportion of products are subject to a licensing policy with a presumption of denial. Pending further policy clarification, oil and gas equipment will not be an area in which the United States would agree to an active program of trade expansion.

JCC Objectives

(C) The U.S. delegation to the Experts Group should explore with the U.S.S.R. possibilities for more constructive trade contacts in the non-strategic area. At the same time, we should explain to the Soviets that the United States wants specific actions to result from

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a JCC meeting, and should seek to achieve Soviet agreement to the following concrete steps which would facilitate the ability of U.S. companies to expand their non-strategic sales in the Soviet Union:

- o A Joint statement by both the United States and the Soviet Union in support of the expansion of mutually beneficial trade.
- o A Soviet policy of beginning to provide bid invitations to U.S. companies.
- o An end to the Soviet ban on seminars at the U.S. Commercial Office in Moscow.
- o Agreement to proceed on certain projects of interest to the United States already under discussion, particularly the Tenneco (formerly International Harvester) combine plant and Abbott baby food plants.
- o Agreement that there are non-strategic industry sectors in which both sides are interested in taking supportive action to facilitate trade expansion.
- o Soviet agreement to have Foreign Trade Ministry publicize to FTOs that they should consider U.S. suppliers equally with other Western suppliers on the economic and technical merits of their products.

POLICY QUESTION:

- (C) Does the SIG-IEP agree that the above objectives for the Working Group of Experts meeting and a possible session of the Joint Commercial Commission are the ones that should be pursued?

POLICY ISSUES

(C) If we are to make progress on achieving our trade objectives with the Soviets, the U.S. delegation should be able to convey to the Soviets that we are willing to examine and discuss the trade problems the Soviets have in non-strategic areas, and to see if solutions to some of our trade differences can be found.

(C) The main Soviet interests at the Expert meeting are likely to be issues that impair Soviet ability to export to the United States and issues relating to Soviet access to U.S. products and technology. The U.S. delegation would tell the Soviets that U.S. technology transfer policies are not subject for discussion. The

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U.S. delegation would be prepared only to explain current U.S. technology transfer policies. Similarly, the Soviets would be told that the extension of MFN and official U.S. credits are not open for discussion. Here also the U.S. delegation would only explain current U.S. policy.

(C) The Soviets have informed us that they plan to raise at the Experts meeting a number of other policy issues summarized below. The U.S. delegation should be prepared to discuss these lesser policy issues with the Soviet delegation. The entire discussion of these issues would be couched in terms of significant Soviet concessions to improve business conditions for U.S. firms and enable them to sell more non-strategic goods in the Soviet Union.

Furskins Ban

(U) Since 1951, the United States has banned imports from the Soviet Union of seven types of furskins. The United States currently has a favorable global trade balance in furskins, with high quality U.S. pelts exported and lower quality foreign pelts imported. A Commerce Department review of the U.S. furskins industry indicates that lifting the embargo from the U.S.S.R. would have little or no effect on domestic production. The Soviets are seeking elimination of the ban more for political rather than economic reasons.

(U) Legislation would have to be introduced in Congress to lift the ban. Congressional attitudes toward any such legislation is unknown, but would probably be based on Congress' view not only of the economic aspect of the U.S.-Soviet relationship, but also on the overall relationship with the Soviet Union--including emigration, forced labor, etc. Depending on circumstances, Congress could be positive or it could be highly negative. The Soviets would read congressional response as a barometer of the overall U.S.-Soviet relationship and feedback effects on other aspects of the relationship would likely result.

POLICY QUESTION:

- (C) Should the U.S. delegation indicate to the Soviets that the Administration would be willing to discuss options with the U.S. Congress to lift the furskins ban, if the Soviets are prepared to improve business conditions for U.S. firms and begin removing some of the trade barriers cited above (e.g., Soviet trade officials apparently have removed U.S. from major projects bid lists)?

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Nickel Certification Arrangement

(U) Under the economic embargo against Cuba, the United States banned the importation of unfabricated nickel-bearing materials from the Soviet Union in December 1983 since that country imports large quantities of Cuban nickel. The Soviet Union was given the opportunity, in advance of the effective date of the import ban, to negotiate a certification arrangement, similar to ones negotiated with our Allies, but failed to accept the U.S. offer for negotiations. The Soviets claim they are not interested in discussing a government-to-government certification agreement, preferring merely to continue existing Soviet certification procedures which do not take account of U.S. Cuban embargo concerns.

(U) At the most recent of several informal discussions with the Soviets in Washington, the Treasury on November 30 indicated that the United States would be willing to consider a written arrangement involving as the signatory Raznoimport (the relevant foreign trade organization) on the condition that any written commitment explicitly state that Raznoimport is acting on behalf of the Ministry of Foreign Trade (MFT). The American Embassy has reiterated the Treasury offer to MFT officials in Moscow. The Treasury recommends that we continue current discussions with the Soviets on the basis of its November 30 offer.

POLICY QUESTION:

- (C) Should the U.S. delegation reiterate the recent Treasury offer to resolve the nickel certification issue?

Aeroflot Landing Rights

(C) As a result of Afghanistan, Poland, and KAL-related sanctions, all scheduled Aeroflot service to the United States and virtually all ties between Aeroflot and the U.S. travel industry have been terminated. Thus far, neither PanAm nor other U.S. carriers have demonstrated interest in a resumption of scheduled U.S. flag service to the U.S.S.R., although there is interest among U.S. tour operators in charter flights to the Soviet Union by U.S. air carriers and PanAm has indicated interest in obtaining overflight rights. Both State and Transportation favor an approach that indicates a willingness to discuss civil aviation matters, but continue to let the Soviets know that before any progress in this area can be made we will need to have a forthcoming response to our proposals on North Pacific safety measures which are designed among other things to help prevent a repetition of the KAL tragedy.

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POLICY QUESTION:

- (C) Should the U.S. delegation be authorized to indicate to the Soviets our willingness to begin discussions on civil aviation matters (a) if we receive a favorable Soviet response to the U.S./Japanese proposal on North Pacific air safety measures and (b) with the understanding that any restoration of Aeroflot service would have to be part of a package which offered a true balance of concessions for U.S. carriers?

Port Access Regulations

(U) The Soviets seek to obtain relief from the port access regulations imposed upon them following termination of the U.S.-U.S.S.R. Maritime Agreement and the imposition of martial law in Poland, and particularly would like an easing of the requirement that their vessels make 14-day advance requests before being given permission to enter U.S. ports.

(U) U.S. agribusiness, in response to Soviet complaints about the 14-day requirement, has voiced the concern that current policy may be having adverse effects on U.S. grain exports to the U.S.S.R. The U.S. maritime industry would vigorously oppose any concessions to the Soviets without some tangible maritime related benefits (e.g., participation in bulk carriage between the United States and the Soviet Union and Soviet pledges not to undercut prevailing conference rates in U.S. liner trades) which would be difficult to obtain under current maritime economic conditions. State and Transportation recommend that we avoid committing ourselves to any change in current practice at the Experts Group, state that any discussions to modify current procedures should take place in the traditional maritime framework, but be prepared to consider reopening discussions on a new maritime agreement in '985. The Department of Agriculture recommends that the U.S. delegation be forthcoming in addressing Soviets concerns about port access regulations.

POLICY QUESTIONS:

- (C) Should the U.S. delegation be authorized to tell the Soviets that any discussions to modify current U.S. port access procedures take place in the traditional maritime framework?

OR

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- (C) Should the U.S. delegation be authorized to tell the Soviets that we are willing to discuss matters in the traditional maritime framework, but caution the Soviets that it could be difficult because of the current economic conditions to satisfy U.S. maritime interests?

OR

- (C) As suggested by the Department of Agriculture: Should the U.S. delegation indicate to the Soviets that the United States will consider relaxing port notification requirements for Soviet grain carriers?

Tax Protocol

(U) A protocol amending various provisions of the U.S.-U.S.S.R. income tax treaty was agreed to in May 1981, but not signed. The Protocol was negotiated to address Soviet criticisms, especially regarding U.S. tax treatment of Soviet employees of Aeroflot working in the United States. A compromise was worked out whereby Aeroflot employees paid back income taxes and interest, and we agreed to exempt Aeroflot employees working in the United States from social security and unemployment taxes, retroactive to 1976 when the basic treaty took effect. This is likely to be an important element in the Soviet position on moving forward on the Protocol. However, it raises for us the difficult issue of making refunds of taxes from the Social Security Trust Fund; we would have to obtain approval from the Social Security Administration (SSA) to sign the provision now. Other changes may also be needed to reflect changes in the U.S. and U.S.S.R. tax laws.

POLICY QUESTION:

- (C) In response to a Soviet inquiry, should the U.S. delegation be authorized to respond to the Soviets that we may willing to move forward on the Protocol, but noting that changes will have to be made?

Drafted by: Commerce/ITA/IEP/EUR/OEESA/USSRD: GRTeske/12-07-84

Clearances: Commerce/ITA/IEP/EUR: FJVargo/12-07-84
Commerce/ITA: OWethington/12-07-84
NSC: RRobinson/12-10-84
State/E: EHurwitz/12-10-84
State/EB: DТаhtinen/12-10-84
State/EUR: DKursch/12-10-84

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Clearances: USTR: WTriplett/12-10-84
 Treasury/OASIA: JGriffen/12-10-84
 Treasury/OFAC: MMuench/12-10-84
 Treasury/OTA: MFields/12-10-84
 DOT: RBourdon.12/10/84
 USDA/FAS: LSebranek/12-10-84

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SIG-IEP ISSUE PAPER ON
U.S. EMBARGO OF SOVIET FURSKINS

Issue

Lifting of U.S. embargo on the importation of seven types of furskin from the Union of Soviet Socialist Republics (USSR).

Background

As mandated by Section XI of the Trade Agreement Extension Act of 1951, President Truman, by executive proclamation dated August 1, 1951, embargoed the importation into the United States of seven types of furskin -- Ermine, Fox, Kolinsky, Marten, Mink, Muskrat, and Weasel -- from the USSR and the Peoples Republic of China (PRC). As a result of the expiration of the Act and subsequent changes in U.S. trade laws, the import prohibition was incorporated into the Tariff Schedules of the United States, Annotated (TSUSA) which sets forth the embargo on furskins, raw or dressed, in Headnote 4 to Subpart B of Schedule 1.

Throughout the 1970s, the Administration unsuccessfully sought removal of the embargo on furskins of both Soviet and Chinese origin. In the case of the USSR, the most recent attempt was made in 1978 but was overtaken by opposition generated by the invasion of Afghanistan in late 1979. In December 1982, Congress approved lifting of the embargo on furskin imports from the PRC when it passed a miscellaneous tariff bill (H.R. 5707); President Reagan signed it into law (P.L. 97-446) in January 1983. Congressional action had full Administration support and followed overtures, first by Secretary Haig and then by President Reagan, to normalize relations with the PRC and seek removal of impediments to improved commercial ties with that country. In a separate earlier Congressional action, MFN treatment was accorded to the PRC also. The PRC produces only mink in commercial quantities. Although no formal economic impact study was undertaken by the United States International Trade Commission (USITC), in comments on pending legislation it concluded the lifting of the embargo would have no substantial adverse effect upon domestic industry.

At the time the embargo on furskins was imposed, these articles accounted for about one-fourth of total Soviet shipments of undressed furs to the United States, valued at approximately \$20 million; they constituted some 10-15 percent of the total value of all goods exported by the USSR to this country at the time. In 1950, the last full year of unrestricted furskin imports from the Soviet Union, mink pelts numbered 59 thousand.

USSR Position

The Soviet Delegation may raise the U.S. embargo on furskins as an impediment to bilateral trade at the Experts meeting. The Soviets have long pushed for removal as a matter of political rather than economic importance to them.

Controlled by Gerald F. Gordon
Decontrol on: OADR

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Options

Option No. 1: Continuation of embargo.

- Pros: 1. Retention of embargo would continue the present status while providing the United States with a bargaining chip in any subsequent trade negotiations with the Soviet Union.
2. Continuation of the embargo would reflect the position of U.S. mink farmers, mink producer associations, and other furskin producer associations opposed to lifting.
- Cons: 1. Of the embargoed seven types of furskin, only mink is produced in significant quantities in the United States.
2. U.S.-produced mink is generally considered superior in quality to foreign mink, including mink of Soviet origin, and thus fully competitive in the U.S. market and markets abroad.
3. Fur wearing apparel manufacturing and marketing associations, national retail organizations, and fur worker unions oppose continuation of the embargo because of raw material supply and cost considerations.
4. Even under the embargo, Russian furskins enter the U.S. market indirectly -- either via Scandinavian auctions or in the form of made-up articles imported from abroad.

Option No. 2: Seek congressional authorization to lift the embargo.

- Pros: 1. Lower furskin prices and a greater variety of furskin types may help rejuvenate the domestic fur wearing apparel manufacturing industry which is labor-intensive and faces stiff competition from low-wage industries abroad.
2. The United States, on a value basis, has a favorable trade balance in furskins, particularly in mink furskins, dressed and undressed.
3. This favorable trade balance is being maintained in the face of the strong U.S. dollar and additional competition by furskin (mink) producers in the PRC since 1982.
4. U.S. mink farm operations, fewer in number but recovering to earlier production levels, appear successful in exploiting marketing opportunities.
5. The apparent high overall U.S. import penetration of mink pelts does not tell the underlying story which sees quality U.S. pelts exported and lower quality foreign pelts imported.
- 5.a. Lifting the embargo would be a small signal to the Soviets that we are prepared to remove barriers to mutually beneficial trade.

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6. The availability of USSR furskin production for exportation to the U.S. market, including that of mink pelts, is limited because the capacity of Soviet industry, a mature industry, is considered near its peak and is committed to meeting the requirements of a huge and growing home market which does not allow much leeway for diversion to exports.
7. The lifting of the embargo on Soviet furskins would not be accompanied by an extension of MFN treatment to imports from the USSR. While furskins, raw or undressed, enter the United States duty-free, skins, dressed, whether or not dyed, would be subject to the full statutory rate of 25-30 percent ad valorem when imported from the USSR.

- CONS: 1. The decline in the number of U.S. mink farms since the late nineteen sixties, which was halted in the past few years, could resume with the availability of larger foreign supplies upon lifting of the embargo.
2. If the United States were to lift the embargo unilaterally and without a quid pro quo, we would be perceived as giving a trade benefit to the Soviets without obtaining a reciprocal benefit.
 3. Greater raw material supply availabilities as a result of the lifting of the embargo on Soviet furskins would not necessarily boost employment in U.S. fur wearing apparel manufacturing. The exit of skilled labor from the domestic industry is only partly associated with limited employment opportunities; it is also associated with a lack of interest in perpetuating the tradition of passing on the skills from generation to generation through a long period of apprenticeship.
Seek congressional approval to

Option No. 3: Lift the embargo for all types of furskin, except for mink.

- PROS: 1. Terminate an embargo on furskins for which there is little or no U.S. production.
2. Isolate sensitivity by mink farmers to competition from Soviet mink pelts while increasing supply of other types of furskin that cannot be sourced domestically.
- CONS: 1. Availability of Soviet furskins other than mink may allow U.S. consumer preference to shift from quality U.S. mink to other quality fur types of Soviet origin.
2. Even the selective lifting of the Soviet furskin import embargo would reduce the current U.S. furskin trade surplus.
 3. There is no economic justification for continuing the embargo.

Option No. 4: Remove the embargo for all types of Russian furskins, but negotiate a ceiling upon the quantity of mink skins that may enter the United States.
Seek congressional approval to

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- PROS: 1. This would allow the U.S. market to adjust to alternative sources of supply for mink skins along with other types of furskins.
2. Within the ceiling established, a more plentiful supply of lower-quality mink skins would become available to the U.S. fur wearing apparel industry and possibly aid in stemming the decline of the industry.
3. By limiting the quantity of mink skins which could be imported from the USSR, U.S. mink farmers would feel encouraged to keep up high-quality mink production for the domestic as well as foreign markets.
- CONS: 1. Mink imports from the USSR would have some impact upon the future overall U.S. trade balance in furskins with the world.
2. Negotiated quotas are not warranted by economic conditions and are contrary to U.S. trade policy.

Discussion

Lifting the U.S. import embargo on seven types of furskin from the USSR would have little or no effect on domestic production. The USSR competes on world markets with U.S.-produced mink as well as with Scandinavian and, recently, Chinese mink. The high quality of U.S. mink furskins, attributed to superior U.S. breeding and feeding techniques, has been the major factor in sustaining U.S. exports in the face of the strong U.S. dollar.

Although it covered only a fairly small part of U.S. furskin imports when it was imposed, the original embargo on imports from the USSR and the PRC may have contributed to the decline of fur trade in the New York market which had served as an international distribution center. In 1950, the last full year before the U.S. import embargo took effect, marten and muskrat, undressed, were the leading articles among the subsequently embargoed seven types of furskins imported from the USSR; mink imports were of relatively little consequence at the time. (Attachment A)

Furskins, raw or not dressed, enter the United States duty-free. Whole furskins, not dyed, under the staged duty reductions negotiated in the Tokyo Round of GATT negotiations concluded in 1979, will be subject to an MFN duty rate of 2.1 percent ad valorem as of January 1, 1987; furskins, dressed and dyed, to a 3.1 percent ad valorem duty. Imports from the USSR, however, not accorded MFN treatment, would be subject to the full statutory rates of 25 percent and 30 percent ad valorem, respectively.

Mink breeding has emerged in the United States since the early 1950s as the largest fur-raising industry. In 1983, the industry produced 4.1 million pelts valued at \$120.1 million. Following a period of decline, beginning in 1969 of both pelt production and the number of mink farms in operation, production has progressively recovered since 1976 while the farm number has stabilized. Domestic production of other furskins covered by the embargo is quite small. The U.S. dressed and dyed furskin industry is relatively small and has shown little or no growth in recent years.

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The bulk of U.S. ranch mink production is exported -- 79 percent by quantity and 75 percent by value in 1983. Most countries buying from the United States dress the skins and manufacture them into finished fur wearing apparel. U.S. exports to Canada and the United Kingdom are typically sold at auction in these countries and then re-exported for fabrication elsewhere. Expanding industries in low-wage Korea and Hong Kong purchase increasing quantities of furskins from the United States and other major producing countries. Canada, after Korea and Hong Kong, is the third largest supplier to the United States of mink wearing apparel.

The U.S. fur wearing apparel manufacturing industry has been declining, as evidenced by a shrinkage in the number of companies, reduced shipments, and loss of employment. Imports, on the other hand, have been capturing an increasing share of expanding retail sales of fur apparel. These imports, equaling 50 percent of domestic production, were valued at \$104 million in 1983. While our industry uses, for the most part, imported pelts to manufacture mink wearing apparel, imported apparel is often manufactured from U.S. pelts.

The U.S. ranch mink industry may eventually be affected adversely by the earlier removal of the U.S. ban on Chinese mink because the PRC mink producing industry is only now coming into its own. PRC production and exports are growing rapidly.

Vigorous opposition to the lifting of the U.S. import embargo on Russian furskins can be expected, inter alia, from the National Fur Farm Organization, the Eastern Mink Breeders Association (EMBA), and the Great Lakes Mink Breeders Association (Blackglama). Mink farms are concentrated in Wisconsin, Minnesota, and Utah.

In addition to fur worker unions, dressers, some auction houses, and national retail organizations, the lifting of the embargo would be welcomed by the American Fur Industries Association, representing apparel manufacturers, and the American Fur Merchants Association.

Attachment

Trade Development/Harry Bodansky/377-0672/12/03/84

Clearances: Commerce/ITA/IEP: FJVargo
State/EUR: SDembski
NSC: RRobinson
USDA: LSebranek
Treasury: GClapp
USTR: WTriplett
State/E: EHurwitz

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Nickel Certification Arrangement

Issue

Should the United States continue its present approach in dealing with the U.S.S.R. on the issue of nickel certification?

Background

1. U.S. Policy on Cuban Nickel. Under the comprehensive economic embargo against Cuba, the United States prohibits importation into the U.S. of merchandise which is produced by Cuba or produced in third countries of Cuban-origin materials (e.g., neither cigars made in Cuba nor cigars produced in Holland from Cuban tobacco are allowed entry into this country). For years we have prohibited the importation into the U.S. of nickel-bearing materials, principally stainless steel, from third countries which are known to import Cuban nickel, on the presumption that some of these materials contain Cuban nickel. When we have discovered that a substantial quantity of Cuban nickel was being imported into a country which in turn exported to the U.S. large amounts of nickel-bearing materials, our consistent practice has been to bar such third-country products from the U.S. Resumption of imports was not permitted unless a certification agreement was reached with the country to ensure that the nickel used in the products was not of Cuban origin. Pursuant to such agreements, a certificate of origin would be required to be issued for each shipment to the U.S. of, e.g., stainless steel, verifying that it had no Cuban content. Under this policy, stainless steel imports into the U.S. were barred from Italy during 1968-1982 and from France between 1965-1970 and again in 1980-1981. We currently have certification agreements in force with each of those countries.

As part of the current policy of tightening the Cuban embargo, the Treasury Department in 1983 initiated talks with three major U.S. trading partners--Japan, the Netherlands, and the Federal Republic of Germany--to discuss those countries' substantial imports of Cuban nickel. Exchanges of notes on this subject were concluded with the governments of Japan and the Netherlands in 1983, and with the F.R.G. on August 10, 1984.

2. Ban on Soviet Nickel. On November 23, 1983, following receipt and verification of information that the U.S.S.R.

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was importing large quantities of Cuban nickel (approximately 18,000 metric tons annually), Treasury published a notice in the Federal Register which prohibited, effective December 22, 1983: (1) the importation of unfabricated nickel-bearing materials directly from the Soviet Union, and (2) the importation of such Soviet materials when transshipped through or only minimally processed within third countries. As a practical matter, the major effect of the ban is to bar direct imports into the U.S. of Soviet nickel cathode (a high-value and particularly pure form of nickel). Additionally, the prohibition bars the indirect importation of this cathode from third countries in cases where it has undergone only limited processing, such as cutting into 1" x 1" size. The estimated loss to the Soviets from the ban is \$20-30 million annually.

In the 30-day period before the prohibition went into effect, the U.S. communicated, through its embassy in Moscow and through the Soviet embassy in Washington, its willingness to negotiate a certification agreement with the Soviet government. No response to this offer was received prior to December 22, 1983. Subsequently, however, Soviet officials discussed the matter with our embassy in Moscow and also with Treasury representatives in Washington. The Soviet Ministry of Foreign Trade and Raznoimport, the relevant Soviet foreign trading organization, have insisted that they are not interested in discussing a government-to-government certification agreement, despite our explanation that this principle has characterized all other certification arrangements we have previously concluded. Instead, the Soviets have offered to provide certificates of origin issued by Raznoimport and certified by the Soviet Chamber of Commerce and Industry, stressing that this is standard Soviet practice and that no exception should be necessary.

Such general certification procedures, however, do not take into account our Cuban embargo concerns. Moreover, our consistent past practice in negotiating arrangements involving certificates of origin has been to obtain an underlying written arrangement or commitment from the foreign government so that the integrity of that government stands behind the certificates. We have not accepted certificates of origin unless they were issued pursuant to an underlying governmental arrangement, and we have not accepted certificates from private bodies such as steel companies or chambers of commerce.

3. Recent Actions. Throughout our dealings with the Soviets on the nickel issue, Treasury has consistently

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consulted with and kept State advised of all developments. Following informal discussions of the matter initiated by the Soviets this summer, Acting Secretary Sprinkel sought guidance and recommendations from the State Department on further negotiations with the Soviets. In background documents accompanying the guidance request, Treasury noted that all prior Cuban-nickel arrangements concluded with foreign countries have involved as signatories either governmental ministries or embassies of these countries. However, the principle of a government-to-government arrangement could probably be made to accommodate an arrangement with a body such as Raznoimport, a foreign trade organization (FTO). FTO's operate under charters approved by the Council of Ministers and maintain a close relationship with the Ministry of Foreign Trade. FTO charters are subject to modification by the Minister of Foreign Trade, who informs the director of the FTO about the goals and priorities established for the FTO by the current economic plan. The FTO director is responsible to the Minister for the FTO's performance with respect to the plan. In the case of Raznoimport, the Minister appoints the director.

In a responding letter of September 22 to Secretary Regan, Secretary Shultz stated that, while a formal certification arrangement with a ministry such as the Ministry of Foreign Trade or the Ministry of Foreign Affairs was preferable, State would not summarily exclude the possibility of accepting a commitment from Raznoimport, provided that it explicitly stated that Raznoimport was acting on behalf of the Ministry of Foreign Trade.

Treasury representatives met in Washington on November 30 with Albert Melnikov, Counselor (Commercial) and Deputy Trade Representative of the U.S.S.R., and with a member of his staff. At that time Treasury indicated U.S. willingness to discuss a written arrangement with Raznoimport, provided that such an arrangement explicitly stated--among other things--that the foreign trade organization was acting on behalf of the Ministry of Foreign Trade. Treasury also explained that any underlying written document would have to refer to the U.S. embargo against Cuba. However, the individual certificates of origin which would have to accompany individual shipments could be less specific; for example, they could refer to merchandise as being wholly of Soviet origin rather than "not of Cuban origin." The Soviet representatives, noting they were without instructions, gave no immediate response. We have asked the U.S. embassy in Moscow to meet with appropriate Soviet officials to emphasize the seriousness of our proposal.

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U.S.S.R. Position

As described above, the Soviets to date have insisted that the United States should simply agree to accept certificates of origin of a type already routinely issued by the U.S.S.R. They have not yet indicated definitively (1) if they would be willing to sign any sort of underlying written agreement which would relate the individual certificates of origin to the Cuban nickel issue, or (2) if they would permit Raznoimport to be a signatory to any such agreement. It is quite possible that they will be unwilling to enter into any written commitment, even with Raznoimport as the signatory.

Discussion

All prior arrangements involving Cuban nickel certification have been concluded with important allies and trading partners of the U.S. (France, Italy, Japan, the Netherlands, and West Germany). In addition, the arrangements have all been characterized by:

- (1) Written documents (either in the form of formal agreements or less formal exchanges of notes)
- (2) Which relate the purpose of the document specifically to the U.S. interest in enforcing its Cuban embargo, and
- (3) Which are concluded between the Treasury Department or a U.S. embassy abroad with either a foreign embassy or an appropriate ministry of the foreign country.

Consistent with the above, in our dealings with the Soviets we have stressed the need for some kind of underlying written agreement to link any certificates of origin to our Cuban nickel embargo. However, as noted earlier, it is by no means certain that the Soviets will be willing to have Raznoimport enter into a written commitment with us. It is possible that the only arrangement they would approve would be for the U.S. simply to accept the standard certificates of origin, issued under existing Soviet procedures which make no reference to the Cuban embargo. Such an approach is not acceptable, as providing the certificates alone would be manifestly less burdensome than the requirements previously placed on our close allies in dealing with Cuban nickel. Also, agreeing to such an approach would mean there would be no underlying arrangement incorporating a governmental commitment.

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Even if the Soviets permit Raznoimport to enter into negotiations with the U.S., there is no guarantee that an arrangement could be reached, since a number of difficult issues would still remain for resolution. Among the most difficult would be obtaining and verifying sufficient information to make credible any certification system which might be adopted. In our past negotiations with other countries, it has been necessary to take into consideration specific facts and circumstances pertaining to such matters as the distribution and use of Cuban nickel within the particular economy; data concerning exports to the U.S. of nickel-bearing materials; and information on organization of relevant industries within foreign countries. Such factors would also have to be considered in the case of the U.S.S.R.

Agency Recommendation: We believe that our dealings with the Soviets to date have taken appropriate account not only of Treasury's past experience in handling this issue with other countries but also of overall U.S. foreign policy interests. Before we communicated to the Soviets on November 30 our proposed accommodation--the offer to consider a written agreement with Raznoimport--the proposal was fully cleared by the highest levels of the State Department. We recognize that it may not be possible to reach an agreement with the Soviets that would protect our own interests in ensuring that the certification agreements are meaningful and that countries are treated fairly and consistently with respect to this issue. In our view, it would be inappropriate to accept any agreement that did not achieve these goals.

Our proposal concerning Raznoimport has been communicated to the Soviet embassy in Washington and will be communicated by the U.S. embassy in Moscow. Any recommendations as to U.S. actions on this issue at the forthcoming January Working Group talks would necessarily be influenced by Soviet actions, if any, prior to that time.

(1) If there has been no official response, we would recommend that Under Secretary Olmer reiterate the proposal made by Treasury--i.e., that we are willing to consider entry into a written arrangement with Raznoimport, provided that there was a statement in writing to the effect that Raznoimport was acting on behalf of the Ministry of Foreign Trade. He could also state that, if such an agreement were reached, individual certificates of origin could be issued that would permit admission of qualifying nickel-bearing Soviet merchandise into the U.S. Such an approach could provide a high-level impetus to consideration of the issue and should emphasize the seriousness of our offer to the Soviets.

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(2) If the Soviets are willing to accept in principle the possibility of a written arrangement with Raznoimport, Under Secretary Olmer could offer to have appropriate Treasury Department officials travel to Moscow for more detailed discussions. (This pattern of U.S. officials traveling to the exporting countries for negotiations has characterized our 1983/1984 dealings with Japan, the Federal Republic of Germany, and the Netherlands.) Conversely, Treasury could handle the matter with Soviet officials in Washington (as in the earlier French and Italian cases).

Note: The Cuban nickel area is a highly technical one, and Treasury has built up a number of significant precedents in dealing with this issue. Although the Soviet economy is organized very differently from those of the other countries with which we have dealt, we believe it is extremely important to treat the Soviets, in all essentials, as we have our close trading partners and allies. Therefore, assuming no Soviet response in the interim, we recommend that any high-level discussions of this issue at the January talks be limited to reiteration of the Treasury proposal. To avoid misunderstanding with the Soviets and to ensure consistency with U.S. legal requirements and precedents, it is important that substantive matters such as the language of the agreement and the linkage to the Ministry of Foreign Trade be deferred for negotiation by a Treasury team.

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Dated: December 7, 1984

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DOC/JBrougher/377-4655/12/10/84

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Aeroflot Landing Rights

Issue: The Soviets are very much interested in obtaining U.S. landing rights for Aeroflot, which were terminated following the imposition of martial law in Poland. The lack of regular Aeroflot service to the U.S. is a major inconvenience to the Soviets and requires most official Soviet visitors to the U.S. to use twice weekly Aeroflot service to Montreal. However, it seems unlikely that the Soviets are now ready to offer us the kind of significant concessions we should require in exchange for a resumption of Aeroflot service.

Background: As a result of Afghanistan, Poland and KAL-related sanctions, all scheduled Aeroflot service to the US and virtually all ties between Aeroflot and the US travel industry have been terminated. These measures seem to hurt the Soviets more than any other remaining sanction, probably because the civil air relationship operated heavily in their favor, because they view this as a significant blow to their prestige, and because of the hard currency cost.

From 1978, when PanAm ceased serving Moscow, to 1982, Aeroflot had a de facto monopoly on direct air service. Even when it operated to the USSR, PanAm was unable to make a profit on the Moscow run. This was due to Moscow's inherent competitive advantage in being able to control its citizenry and to PanAm's lack of market access, its inability to use wide-bodied aircraft, and its lack of overflight rights to points in Asia. Pan Am's market access was severely restricted because of prohibitions placed on direct ticket sales for local currency. Other doing-business hardships encountered included inadequate sales offices and a wide variety of other pressures for traffic originating in the Soviet Union to fly Aeroflot rather than a U.S. flag carrier. Overall, the Soviets insistently sought to control virtually all aspects of operation in the U.S.-Soviet aviation market. The Soviets have hinted they would be more accommodating this time around on overflights and wide-bodied aircraft. Neither PanAm nor other US carriers have demonstrated any interest in a resumption of scheduled US flag service to the USSR, although there is interest among U.S. tour operators in the charter flights by US air carriers. Moreover, the U.S. aviation community has yet to address the question of balance of economic benefits. PanAm has indicated, however, that it would be interested in obtaining overflight rights, which could save up to several million dollars in fuel costs annually.

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Bilateral civil aviation relations, already bad, were set back even further by the KAL shootdown and our response. Soviet denial of responsibility for KAL, refusal to consider compensation for the victims, and unwillingness, to date, to respond positively to proposals for new North Pacific safety measures to prevent a repetition of the tragedy have been serious additional complications. Furthermore, there may be one additional obstacle to renewed Aeroflot service. New FAA noise regulations, which go into effect January 1, 1985, will apparently pose a problem for most Soviet airliners. It appears only one Soviet long-range aircraft, the IL-62M, can comply with the new regulations.

U.S.S.R. Position: The Soviets raise the question of restored Aeroflot service regularly, and it almost certainly will be mentioned by them at the Experts' Working Group. In an effort to obtain some leverage for Aeroflot the Soviets have linked it -- as a "practical" rather than "political" matter but nonetheless very clearly and firmly -- with questions not related to civil aviation: the opening of new consulates in Kiev and New York, and conclusion of a new exchanges agreement.

We have rejected the assertion of linkage between the new consulates, bilateral exchanges, and Aeroflot, and maintained that these disparate issues should be discussed separately, on their merits. Specifically, on Aeroflot, we have cited the failure of the Soviets to respond on proposals for technical measures to improve air safety in the North Pacific and the overall unbalanced nature of our previous civair relationship as the major obstacles to a resumption of Aeroflot service. At an early stage of this dialogue, we also raised the matter of our KAL claims, but we have not stressed this point in recent discussions.

Option A:

Give sympathetic consideration to Soviet requests for a resumption of Aeroflot service to the U.S., provided that the Soviets cooperate with us on North Pacific safety measures and are prepared to make meaningful concessions in other areas.

PROS

Would facilitate commercial contacts with the USSR by making it easier for Soviets to travel to and from the U.S.

Might lead to Soviet concessions in other areas of interest to us.

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Would be totally contrary to our general policy of strictly avoiding non-aviation trade-offs in exchange for granting foreign carriers U.S. landing rights. Therefore, it would be strongly opposed by the U.S. civil aviation industry.

By giving away our major bargaining chip would make it highly unlikely U.S. air carriers would ever obtain significant concessions from the Soviets.

It is difficult to conceive of economic concessions in areas other than civil aviation which the Soviets might offer us as compensation for a restoration of Aeroflot landing rights. (We should continue to reject any linkage of Aeroflot service to the reopening of Consulates.)

A major concession to the Soviets in the area of civil aviation, given the continued Soviet refusal to accept any responsibility for KAL, could subject the Administration to heavy domestic political flak.

Because Option A is so totally contrary to U.S. international aviation policy, the Department of Transportation opposes Option A and does not consider it as within the realm of consideration as a possible option.

Option B

Indicate to the Soviets that we would be willing to consider follow-up discussions on civil aviation questions of interest if they are ready to respond positively to our proposals on North Pacific Safety measures. However, we would point out at the same time that any restoration of Aeroflot service would have to be part of a package which offered a true balance of concessions for U.S. carriers. These follow-up discussions would be conducted on an expert level and be confined to the usual civil aviation interagency group.

PROS

This approach makes it clear a restoration of Aeroflot service is contingent on a package which would include significant economic benefits for U.S. air carriers.

Would be welcomed by U.S. industry

Would avoid the re-establishment of a one-sided civil aviation relationship in the Soviets' favor.

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CONS

The Soviets will argue that the lack of regular Aeroflot service will inhibit the development of commercial contacts with us.

The Administration may also be subjected to substantial domestic political criticism for taking this approach, if there is still no Soviet acknowledgment of responsibility for KAL.

Discussion: State and Transportation favor an approach along the lines of option B. While we should indicate a willingness, in principle, to discuss civil aviation matters, we should continue to let the Soviets know that before any progress in this area can be made we will need to have a forthcoming response to our proposals on North Pacific Safety measures. (Transportation believes there is sufficient linkage between safety issues and civil aviation rights to take this position.) We gave these proposals to the Soviets in February 1984 and have yet to receive a reply, although the Soviets have given us some indication recently that they are considering these recommendations. If progress on technical measures is forthcoming, a possible response on our part would be a termination of the KAL sanctions which effectively prohibit contacts between U.S. carriers and travel agents and Aeroflot.

We should continue to reject Soviet efforts to link a resumption of Aeroflot service with the issue of a reopening of consulates or cultural exchanges. Progress towards a balanced civil aviation agreement will almost certainly be slower than the Soviets would like and we will have to make a continuing effort to avoid being pressured into a premature settlement which, in effect, would probably result in an agreement heavily balanced in the Soviets' favor.

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 USDOC/JBrougher/377-4655/12/10/84

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MARITIME RELATIONS/PORT ACCESS

Issue

The Soviets seek to obtain relief from the port access regulations imposed upon them following termination of the U.S./U.S.S.R. Maritime Agreement and the imposition of martial law in Poland, and particularly would like an easing of the requirement that their vessels make 14-day advance requests before being given permission to enter U.S. ports. They are likely to raise the matter at the Working Group of Experts as an obstacle to trade, even though this question has not been previously addressed in the forum.

Background

For national security reasons merchant ships from Communist countries are subject to advance notification requirements for calls at U.S. ports (Magnuson Act, 50 USC 191, and various executive orders and NSC decisions). These requests are made to the Coast Guard, acting on behalf of U.S. defense and security agencies.

From 1972 to 1981 bilateral maritime agreements with the United States accorded to Soviet merchant vessels 4-day notice access to 40 U.S. ports in exchange for cargo sharing concessions to U.S. merchant ships. At their high point in the late 1970's, Soviet vessels averaged more than 100 port calls a month in the United States and were active participants in the U.S. liner crosstrades. Discussions on a possible renewal of the last agreement were suspended at the end of 1981 as part of the U.S. response to the imposition of martial law in Poland. As a result, the United States reintroduced a 14-day advance request requirement on Soviet merchant vessels.

U.S. agribusiness, in response to Soviet complaints about the 14-day requirement, has voiced the concern that current policy may be having adverse effects on U.S. grain exports to the U.S.S.R. They have shown some sympathy for the argument that the Soviets, who at the moment are the largest customer for U.S. grain, must cope with port access requirements which are more stringent than those applied to other Communist countries. Nevertheless, Soviet efforts to push for liberalization of our port access requirements in bilateral grain consultations have been resisted thus far.

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The maritime industry would vigorously oppose any concessions to the Soviets on the port access issue without some tangible maritime-related benefits being given in return by the U.S.S.R., such as use of U.S.-flag ships to carry portions of grain and other cargoes and making ironclad pledges not to undercut prevailing conference rates in U.S. liner trades. The industry would be extremely upset to learn that a U.S.-U.S.S.R. trade group was proposing to discuss this matter out of its historic maritime format.

U.S.S.R. Position

The Soviets complain consistently that the 14-day request regime inhibits their ability to carry bilateral cargo, and imply that this may inhibit their grain purchases from us. In our November 1984 grain consultations, they suggested we consider a liberalization of our current requirement for grain carrying vessels only.

Options

A. Consider a relaxation of port notification requirements from 14 to 7 days for Soviet grain carriers only.

Pros: Would demonstrate some U.S. flexibility on an issue which has become a significant irritant in our bilateral grain trade.

Demonstrate to American farmers and the grain trade our willingness to do all we can to promote grain sales to the Soviets.

Cons: Would represent, in effect, a unilateral U.S. concession to the Soviets.

Would give away one of the few pieces of leverage we have in future maritime negotiations with the Soviets.

Would be strongly opposed by the U.S. maritime industry, which would get no benefit from the surrender of a key bargaining chip.

May elicit labor protests.

Could be opposed by Defense and counterintelligence interests.

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B. Propose a relaxation of pre-clearance requirements in exchange for a Soviet agreement to increase significantly their minimum annual purchase of U.S. grain. (USDA does not agree with this option--see USDA attachments.)

Pros: Would both remove an irritant in our grain trade and produce a concrete benefit for the U.S. agricultural sector.

Would force the Soviets to pay a price for improved port access, albeit not in the maritime area.

Cons: Would create damaging precedent of linking other issues to Soviet grain purchases which would proceed as Soviet needs change.

Would give away U.S. leverage for future maritime negotiations.

Would be strongly resented by the U.S. maritime industry, who would view this as a sellout, at their expense, to placate agricultural interests.

May elicit labor protests.

Could be opposed by Defense and counterintelligence interests.

C. Inform Soviets that we could consider modifying port access procedures for Soviet-flag bulk vessels, in connection with reopening talks restricted to bulk cargo sharing and acceptance of a mutually satisfactory rate for the carriage of grain by U.S.-flag vessels.

Pros: Would keep discussion of this issue in a maritime framework, and avoid industry charges of a sellout.

Would show U.S. willingness to at least consider a change of policy on port notification.

Might hold out the possibility of at least a token return to the Soviet grain trade for U.S. vessels.

Cons: At present, world charter rates are too low for the Soviets to consider paying a differential needed to assure U.S.-flag vessel participation in the trade.

Both the USG and the Soviets are unwilling to subsidize carriage of grain to the U.S.S.R. in U.S.-flag ships.

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Would be criticized by the U.S. shipping industry, unless substantial concessions in the bulk carriage area were received for U.S.-flag vessels.

D. United States could agree to consider modification of the port access procedures for Soviet liner and bulk vessels in connection with the immediate reopening of talks aimed at producing a new maritime agreement covering both liner and bulk bilateral trade.

Pros: Would be considered, from a foreign relations standpoint, as a step to improve relations.

Since much of the negotiation was completed before imposition of the Presidential suspension in December 1981, resumption of negotiations might not be difficult, assuming the Soviets have not changed their views on major issues.

Cons: U.S. liner shipping segment of industry is strongly opposed to a new agreement giving Soviets facilitated access to crosstrade cargoes.

Current world freight rate market for grain cargoes is too low to expect an accommodation. In order to guarantee U.S.-flag vessel participation, the USG or Soviets would have to subsidize U.S.-flag carriage.

Failure to reach an accommodation, instead of bolstering image of better relations, could produce opposite effect and be seen as another source of friction.

E. We would avoid committing ourselves to any change in current practice at the Working Group of Experts meeting and state that any discussions to modify current procedures should take place in the traditional maritime framework.

Pros: Avoids antagonizing the U.S. shipping industry.

Would preserve the major U.S. bargaining chip (port access) until such time as mutually advantageous maritime concessions are feasible.

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Would minimize the amount of premium or subsidy that would have to be paid by either the USG or Soviets for the carriage of grain by U.S.-flag vessels, thereby improving chances for successful conclusion of an arrangement.

Would give the Administration time to secure support from U.S. liner segment that opposes an arrangement.

Cons: Offers no possibility of negotiated settlement of this question in the near term.

Continued refusal by the Administration to consider any modification of the current system may be viewed as a lack of support for U.S. grain exporters at a time when they are facing intense international competition.

Discussion

The Departments of Transportation and State support Option E for the January Experts meeting, although both agencies agree that we may have to consider other options or approaches if political and economic conditions continue to make a new maritime agreement unfeasible. This option affords the United States the opportunity to await the development of more favorable conditions in the world charter market for the carriage of grain to the U.S.S.R., thus improving the chances of ultimate success in any future maritime negotiations with the Soviets. Most importantly, Option E permits the retention of the major U.S. bargaining chip in future shipping negotiations with the Soviets. Despite continued complaints by the Soviets on port access, there is little evidence to date that our requirements have affected their grain purchases from us. Since vessels in the grain trade must generally notify grain companies at least two weeks prior to their arrival in U.S. ports, for purely commercial reasons, compliance with a 14-day advance notification would not seem to place a meaningful burden on the Soviets. Interestingly, the Soviets now carry a larger percentage of the trade in their ships (about 30 percent) than they did when a maritime agreement was in force. U.S.-flag carriers, which then had a significant portion of this business, now carry none of it.

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The Soviets undoubtedly resent the current situation where they, our best grain customers, are saddled with the most onerous port access regulations. U.S. agribusiness will continue to be receptive to their complaints and can be expected to place more and more pressure on the Administration to ease the present regime. There is likely to be a crescendo of complaints that we are insensitive to the plight of our farmers. Pressures from this source should only be relevant to Soviet ships engaged in our grain trade and should not lead to considering any changes in port access requirements for other Soviet vessels.

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DOT/MVScocozza/426-4544/11-28-84
STATE/EUR/SOV:TWSimons, Jr./632-3738/11-28-84
STATE/E:EHurwitz/632-8854/11-28-84
STATE/OF:SThompson/632-0646/11-28-84
STATE/EB/TT/MA:RRoberts/632-0705/11-28-84

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DEPARTMENT OF AGRICULTURE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

DEC 1 0 1984

TO: Lionel H. Olmer, Under Secretary of Commerce
International Trade

FROM:

A handwritten signature in dark ink, appearing to read "Dan Amstutz", written over the printed name and title.

DANIEL G. AMSTUTZ

Under Secretary for International
Affairs and Commodity Programs

SUBJECT: Comments on Port Access Issue for SIG-IEP Review

The paper on Maritime Relations/Port Access is substantially at odds with the view expressed on several occasions by the Department of Agriculture. Except for Option A, which the paper does not endorse, the options presented would sacrifice grain export interests for Maritime demands that would be impossible to meet. Option B, which suggests possible modifications of the purchase minimum in the grain agreement as a quid pro quo for port access improvements is completely unacceptable.

In view of the short time-frame for draft review, we are attaching one of our earlier papers on this subject with the understanding that it will be circulated as our view along with the maritime paper.

Attachments

SUBJECT: Discriminatory Freight Requirements on Chinese and Soviet Vessels

We have contacted a number of traders in an attempt to quantify the problem of notification requirements for Chinese and Soviets-flag vessels. All those contacted agree that while it is very difficult to assess actual costs borne by Chinese and Soviet buyers, there is a "cost" in terms of added inconvenience for planning shipments and psychological fears of added costs if shipping schedules do not go as planned. To avoid cash outlays from the requirements means extensive forward planning, developing alternative schedules such as going to another country and picking up an alternative cargo, or purchasing grain in countries which do not discriminate against Chinese and Soviet vessels.

Currently, our policy of discriminating against Soviet and Chinese vessels means that requests for entry into U.S. ports to pick up cargoes of U.S. grain must be made 14 calendar days in advance for Soviet flag vessels and 7 working days in advance for Chinese flag vessels. In addition, Chinese-flag vessels are required to pay \$1 per ton extra "port tonnage dues."

Grain buying agency representatives from both countries often complain to us and to our export companies that these requirements act to discourage our grain trade. While many of the complaints are for non-economic reasons, there is evidence that these requirements are unnecessary and will gain us nothing. Experience under maritime agreements between 1972 and 1983 demonstrated that 4 days notice is adequate from a security standpoint. Moreover, it has been seen, in the negotiations for new maritime agreements with both countries over the past few years, that the length of the notification period is not a sufficient bargaining tool to get the Chinese and Soviets to agree to taking a significant portion of their U.S. grain trade on U.S. vessels (at \$50 to \$60 per ton premium). Also, reciprocity is not an important issue because very few, if any, U.S.-flag vessels go to these countries. Most important of all in a competitive sense is that no other grain supplying country makes this requirement. Thus, little, if any gain accrues to the U.S. from maintaining such stringent requirements, except perhaps to the maritime people who hold out an ill-fated hope of forcing these countries to pay higher U.S. freight rates. Meanwhile, our farm sales remain victim to such thinking.

In economic terms, the notification period costs Chinese and Soviet ships flexibility, time and cash. The costs grow as the use of their vessels grow; we expect that in 1984, 30-40 percent of each country's grain trade with the

Daniel G. Amstutz

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U.S. will be shipped on their own vessels because of increased availability in the currently depressed ocean freight market. The depressed ocean freight market explains why more Soviet and Chinese vessels are available to transport grain. State's argument that more of these vessels coming to U.S. ports proves the discriminatory freight requirements are not a hindrance to grain trade is based on a lack of understanding of the economics of ocean transportation costs.

The cost of the discriminatory freight requirements can easily make a difference of several dollars per ton of grain. These added costs may make little difference in a market in which Chinese or Soviet buyers need grain badly. This could turn out to be true this year for the Soviets. But in years when those countries need less grain than normal (as is true of China this year) these added costs per ton can make the difference between purchases from U.S. farmers and purchases from Argentine or Canadian farmers.

Some additional examples gleaned from conversations with traders illustrate the economic costs of this policy:

- 1) A Soviet-flag vessel bound for Argentina to pick up grain after unloading cargo in Cuba was unable to go to Argentina because of an unexpected backlog. It could reach a Texas port to pick up U.S. grain in 24 hours but would have had to wait 14 days and pay demurrage charges of up to \$8,000 or \$10,000 per day, or as much as \$130,000 for the period. It went elsewhere to prevent bearing this needless cost.
- 2) Traders cite several examples earlier this year in which desirable ships became available but were forced to wait out the discriminatory period in port--e.g., one at Portland for five days and another in the Gulf for four days--for a cost of roughly \$30,000-\$33,000. This does not build good trade relations for one of our few good commercial cash customers.
- 3) In many cases vessels simply cannot afford to wait and it can cost us a sale. One grain trader said that he has been asked a number of times to find Canadian grain for the Soviets to load at St. Lawrence. This costs the U.S. anywhere from 20,000-50,000 tons per ship.
- 4) Frequently, because of the nature of grain movements and freight rates, it can become cheaper to supply grain out of an Atlantic port instead of the originally-designated Gulf port. Sellers offer to switch, saving the buyer a few dollars per ton on the freight, as well

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as 3-4 days steaming time. But since Chinese and Soviet vessels have to start the notification process all over again, such opportunities are not available to Soviet and Chinese vessels. With a 4-day notice policy, the buyer could save as much as \$150,000 or so on a single vessel, depending upon the vessel size.

- 5) Finally, the Chinese and Soviets take matters of principle very seriously and have cited examples in which their treatment by selling countries as important customers has made a critical difference in terms of where they have purchased large quantities of grain.

In summary, it is obviously impossible to "prove" there would be additional sales from removing the discriminatory requirement. Further, while it is very difficult to place a specific cost on these requirements, it is clear from discussions with grain traders that this unequal treatment of Chinese and Soviet shipping vessels colors their view of the U.S. as a reliable supplier and fair trader of grain. Removal of the grain embargo was a first step to reestablishing our role as a major supplier of grain to the Soviet market; now it is time to remove the remaining discriminatory obstacles.

Protocol to Tax Treaty

Issue

A protocol amending various provisions of the U.S.-USSR income tax treaty was agreed to in May 1981, but not signed. Should we revive that project?

U.S. Position

Treasury is reviewing the desirability of moving forward with the protocol. Two political issues must be resolved favorably for the decision to be affirmative. One is the basic question whether it is appropriate to negotiate a tax agreement with the USSR at this time. That is a decision for the Secretary of the Treasury to make. The second issue is whether we are still willing to honor the provision in the protocol which exempts from U.S. social security and unemployment taxes employees of Aeroflot stationed in the United States. There are no longer any Aeroflot employees working in the United States; but the protocol is retroactive to 1976, when the basic treaty entered into force. Thus, if the protocol were enacted, refunds of those taxes would have to be made. The decision to grant that exemption was cleared within the Administration at the time, and approved as a reasonable solution to a very difficult and unique problem which had arisen under the treaty. We would not agree to it with another country. And we would have to get the approval of the Social Security Administration to sign that provision now.

Given the lapse of time since the protocol was initialled, if the decision is made to go forward, we would want to reconsider other provisions as well.

Background

The Protocol was negotiated basically to address two USSR criticisms of the treaty. They wanted Aeroflot employees stationed in the United States to be exempt from U.S. tax on their salaries; in fact, they argued that the treaty provided such an exemption and refused to withhold and pay over the taxes. They also wanted the first paragraph of the exchange of letters accompanying the protocol to be worded more reciprocally. We could not agree to the first request, but finally worked out a compromise whereby they paid back income taxes and interest, and we agreed to exempt Aeroflot employees working in the United States from social security and unemployment taxes, retroactive to 1976 when the basic treaty took effect. We agreed to their second request. The protocol makes some other clarifying changes and adds some new provisions, for example a broader exemption of interest and a provision on dividends. The protocol was submitted to the Department of State for its review and signature. For political reasons it was not approved for signature and, therefore, was not sent to the Senate.

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Clearances:
NSC/Robinson/395-3622/12/10-84
USTR/WTriplett/395-4543/12/10/84
USDOC/JBrougher/377-4655/12/10/84

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